



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of June 11th 2010 to June 17th 2010

Indicator	Date of release	Pe-riod	BRE forecast	Consen-sus	Last	Comment
Industrial output	Jun 18	May	5.7%	8.4%	10.4%	Worse business climate. Probably under the influence of extraordinary, on-off factors.
PPI	Jun 18	May	0.4%	0.4%	-0.5%	First and foremost: zloty weakening affecting price expectations. Correction of prices of copper and led offset by PLN depreciation.
Retail sales	Jun 24	May	2.5%	3.1%	-1.6%	Significant drop of business tendency indicators. Floo effects rather negligible. Base effect from last month fades (ceteris paribus +3pp.). Sharp drop in VAT revenues (from 22% to 8% y/y suggest our forecast is on the optimistic side...

In Focus / Macroeconomics

Mixed news on inflation front

Although CPI inflation hit only 2.2% its perspectives, including especially monetary policy relevant horizon, are evolving according to our earlier assumptions as labor market is on the visible mend. Such a constellation of data may anesthetize the real sphere concentrated MPC and end-up with pricing-in the behind-of-the-curve scenario as soon as inflation will start to rise again (late summer).

CPI inflation hit 2.2% y/y in May, a notch higher than forecast by the Ministry of Finance and a way below market consensus and our forecast (2.4% and 2.5%). The ultimate cause of the difference in forecast lies mainly in food prices, not once the Central Statistical Office (GUS) proved it measures prices in a specific way (i.e. growth rate of prices in some food categories is very unlikely to break previously established, historical seasonal range – it was the case this time...again). It is another lesson the measurement of prices should be always filtered through tail risk probabilities! As for the other categories, they were more or less benign (highest “spike” in fuel prices +2.4% m/m), including core inflation (estimated right in the middle of 1.6-1.7% y/y range). Next to months are likely to bring a minor fall in inflation gauge (in June price growth is likely to decelerate to 1.9-2.0 and then slightly below 2.0% in July). Such expectations are shaped by the path of fuel prices (and possibly benign food markets), recent PLN depreciation and still “active” statistical base effects from the last year. Inflation is set slowly to accelerate since Autumn on improving situation in the labor market and on aftermath of NBP’s exchange rate steering.

As for the labor market data, we got 11k growth in employment (translating into +0.5% y/y) accompanied by 4.8% y/y surge in nominal wage. Although the information disseminated by the Central Statistical Office is very brief, we see that the labor market is on the mend. As we believe the dip in employment expectations provided by GUS to be temporary (and somehow detached from reality as other business indicators provided by different institutions do not confirm such a tendency) the improvement in the labor market has a chance to gain momentum in coming months. As for the recent one-off effects, the flood will be more or less neutral for statistics and temporary job hiring is likely to be reflected in broader unemployment measure.

MID-TERM FORECATS

Indicator	2007	2008	2009	2010	2011
GDP y/y (%)	6.5	4.8	1.7	3.0	4.2
Inflation rate (% , average)	2.4	4.3	3.5	2.6	2.9
Current account (% of GDP, average)	-4.5	-5.3	-1.6	-2.7	-3.7
Unemployment rate (end-of-year)	11.4	9.5	11.9	12.1	10.9
NBP repo rate (end-of-year)	5.00	5.00	3.50	3.75	5.00

Indicator	2009				2010	
	Q3	Q4	Q1	Q2	Q3	Q4
GDP y/y (%)	1.7	3.1	3.0	2.3	3.1	3.9
Inflation rate (% , average)	3.5	3.3	3.0	2.1	2.2	2.8
NBP repo rate (end-of-quarter)	3.50	3.50	3.50	3.5	3.5	3.75

Bold denotes changes from the last release with arrows showing the direction of changes

Fixed Income

The calm before the storm ?

Another quiet week without any spectacular events seemed to be a copy of the previous one. The market still traded within a solid, narrow range following the global mood but seemed to become less volatile than it was in the past few weeks. We could easily divide the last few days into two parts.

In the first one, as we expected, the newly appointed central bank governor Marek Belka proved to be a positive news for the longer end of a yield curve. We could observe quite a good demand on treasury bonds especially in 5Y sector. The curve has slightly flattened testing the 5Y swap outright at 5.05% level and 2Y at 4.42% that moved down the 2y5y spread to 63-64 points (68-

70 last week). On the short end of the curve we believed the CPI figure would exceed the Ministry of Finance expectations. The release came out higher than expected but not enough to adversely affect the FRA market (MinFin 2.1%, BRE 2.5% , the release 2.2%). The FRA market became stable without any substantial turnover.

In the second one, the Ministry of Finance tried to sell up to 3.0 bn face value of 10Y treasury bonds (5.25% DS1020) on a regular auction. Unfortunately the overall demand failed to reach the target probably the first time this year that might look like the market has been fed up with domestic bonds exposure. As a result the 5Y swap came back to its top range of 5.15% and 2y5y spread to 68 points again.

Would “the failure” of a bond auction mean the reverse of a trend or a temporary lack of interest ? If the worse scenario came true, the quite rapid upward move on a longer end of a yield curve could be inevitable....

AUCTIONS

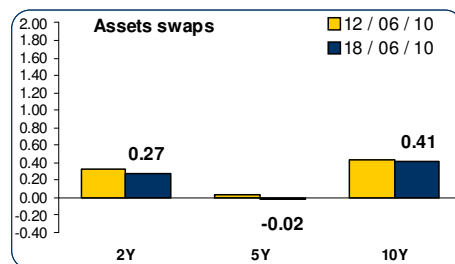
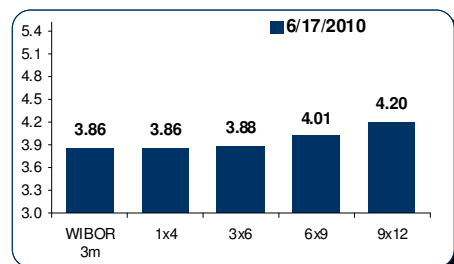
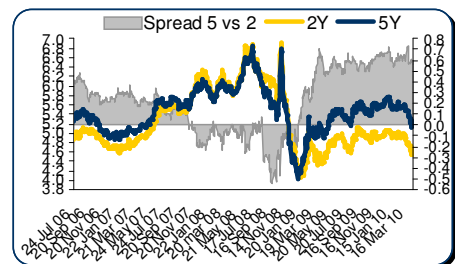
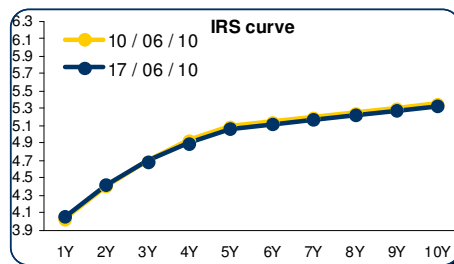
	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	12/9/2008
26 Week T-bills	-	-	4.456%	5/4/2009
52 Week T-bills	6/21/2010	-	3.946%	6/14/2010
2Y T-bond OK0712	7/7/2010	-	4.675%	6/2/2010
5Y T-bond PS0415	7/14/2010	-	5.156%	5/12/2010
10Y T-bond DS1020	7/21/2010	-	5.790%	6/16/2010
20Y T-bond WS0429	7/21/2010	-	6.170%	9/23/2009

Money Market

Global outlook depreciates the value of local data

Liquidity stable and above 3%. All the money bills were purchased (77.5 billion pln) and tomorrow’s auction will judge whether the end of the reserve is going to be cheap or not. Figures without any market impact (CPI 2.2 vs 2.3% expected and wages 4.8 vs 3.8 expected) since only the global outlook is important now. T-bills average yield 3.94% and this is also the probable level for the next auction. World Cup has decreased the overall activity, therefore next weeks are not going to be busy either.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty ranged

This week Zloty (EURPLN), after gaining almost 3% in previous one, was traded in narrow, 4.0550-4.1000 range mirroring relatively quiet global markets. Globally, Spanish bank's problems has not translated into worse investment sentiment and EURUSD cross headed up to 1.24. Although this move supports PLN, Zloty has not followed it, hovering just above its strong support of 4.05/4.0650 level. This fact, has lowered the correlation between EUR/PLN and EUR/USD to -0.65. USD/PLN's trading range was defined by 3.28-3.37.

Implied volatility lower

Stronger Zloty plus lower realized volatility (last week about 6%) has added up some pressure for lower implied volatilities. Reaction, supported by longer term realized vols (1M about 16%), was not major: 3M benchmark was traded in narrow, 12.25-12.75, range. Smile and currency spread were also traded at same levels, 3M benchmarks were: 3.75 for 25D EURPLN RR, and 8.75 for USDPLN vs EURPLN spread.

Short-term forecasts:

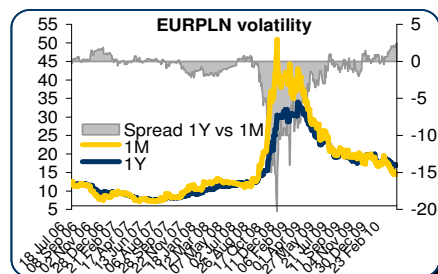
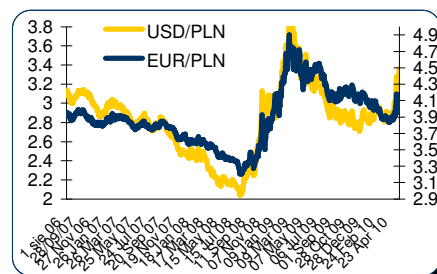
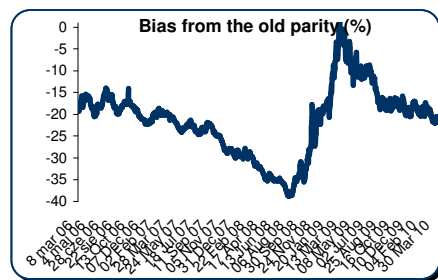
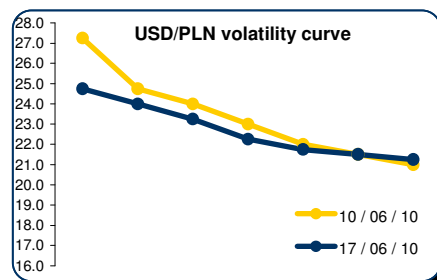
SPOT
Main supports / resistances:
EUR/PLN: 4.0550 / 4.2000
USD/PLN: 3.2500 / 3.4000

We leave 4.06-4.24 as the most possible to play out in coming days. We believe minor and major changes are going to be animated by global markets. However, EURPLN is close to bottom of range and the break of 4.06 support cannot be excluded.

OPTIONS

Influence of periods of low realized volatility is netted out by days of boosted one. Sentiment fluctuations provides enough bargains to look for higher gamma. However, it has to be taken into account that the historical volatility is now heading lower. From the Vega point of view it is possible to see some downward potential, although as soon as situation calm down, the tendency may be somehow (temporarily?) disturbed.

FX CHARTS



MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
11/06/10	3.77%	3.86%	3.87%	3.91%	4.34%	4.15%
14/06/10	3.80%	3.86%	3.90%	3.90%	4.10%	6.59%
15/06/10	3.73%	3.87%	3.90%	6.49%	4.10%	4.14%
16/06/10	3.78%	3.86%	3.89%	3.91%	4.10%	4.14%
17/06/10	3.76%	3.86%	3.90%	3.91%	4.15%	4.14%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
11/06/10	3.87%	3.90%	4.02%	4.20%	4.21%
14/06/10	3.85%	3.87%	4.00%	4.22%	4.21%
15/06/10	3.85%	3.88%	4.03%	4.23%	4.22%
16/06/10	3.86%	3.88%	4.02%	4.20%	4.20%
17/06/10	3.86%	3.88%	4.02%	4.21%	4.21%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)								
date	1Y		2Y		5Y		10Y	
	WIBOR	TB	IRS	OK0112	IRS	PS0511	IRS	DS1017
11/06/10	4.15%	3.95%	4.40%	4.35%	5.09%	5.12%	5.35%	5.78%
14/06/10	6.59%	3.93%	4.41%	4.36%	5.06%	5.05%	5.31%	5.73%
15/06/10	4.14%	3.94%	4.42%	4.32%	5.06%	5.04%	5.33%	5.74%
16/06/10	4.14%	3.94%	4.42%	4.32%	5.06%	5.04%	5.33%	5.74%
17/06/10	4.14%	3.94%	4.42%	4.32%	5.06%	5.04%	5.33%	5.74%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	10/06/14	11/06/14	96.163	3.95%	1200	3058	1175
OK0712	10/04/07	12/07/25	89.301	4.54%	3000	6726	2999
PS0415	09/04/21	15/04/25	102.209	4.99%	3000	6623	3000
DS1019	10/06/16	19/04/25	95.807	5.79%	3000	2965	2430

FX VOLATILITY

date	USD/PLN 0-delta straddle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
11/06/10	24.00	22.25	21.75	21.25	5.25	6.40	0.75	0.95
14/06/10	24.00	22.25	21.75	21.25	5.25	6.40	0.75	0.95
15/06/10	24.00	22.25	21.75	21.25	5.25	6.40	0.75	0.95
16/06/10	24.00	22.25	21.75	21.25	5.25	6.40	0.75	0.95
17/06/10	24.00	22.25	21.75	21.25	5.25	6.40	0.75	0.95

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
11/06/10	3.3761	4.0909	-14.89%
14/06/10	3.3390	4.0838	-13.87%
15/06/10	3.3397	4.0765	-12.42%
16/06/10	3.3064	4.0653	-13.00%
17/06/10	3.3095	4.0811	-13.17%

Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

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